Supreme Court of the United States

OCTOBER TERM, 1955

No. 202

MICHAEL STELLA, on behalf of himself and all other stockholders of Kaiser-Frazer Corporation,

Petitioner,

—against—

HENRY J. KAISER, JOSEPH W. FRAZER, EDGAR F. KAISER, G. G. SHERWOOD, E. E. TREFETHEN, JR., CLAY P. BEDFORD, W. A. MACDONALD, O. B. MOTTER, HICKMAN PRICE, JR., WALSTON S. BROWN and KAISER-FRAZER CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

LEWIS M. DABNEY, JR.,
Counsel for Petitioner,
165 Broadway,
New York 6, New York.

INDEX

Table of Cases Cited

OTHER AUTHORITIES CITED

Supreme Court of the United States

OCTOBER TERM, 1955

No.

MICHAEL STELLA, on behalf of himself and all other stockholders of Kaiser-Frazer Corporation,

Petitioner,

—against—

HENRY J. KAISER, JOSEPH W. FRAZER, EDGAR F. KAISER, G. G. SHERWOOD, E. E. TREFETHEN, JR., CLAY P. BEDFORD, W. A. MACDONALD, O. B. MOTTER, HICKMAN PRICE, JR., WALSTON S. BROWN and KAISER-FRAZER CORPORATION,

Respondents.

PETITION FOR WRIT OF CERTIORARI

To the Honorable, the Chief Justice and Associated Justices of the Supreme Court of the United States:

Michael Stella, a stockholder of Kaiser-Frazer Corporation, acting on behalf of himself and all other stockholders of Kaiser-Frazer Corporation, respectfully prays for the issuance of a writ of certiorari to review the judgment of the United States Court of Appeals entered herein April 11, 1955, affirming the judgment of the United States District Court dismissing his complaint.

Basis of Jurisdiction

The jurisdiction of this Court is invoked under 28 U. S. C. §1254. The original opinion of the Court of Appeals was handed down December 7, 1954 but entry of judgment was stayed by timely filing of a petition for rehearing. On January 3, 1955, the Court entered its order giving leave to file additional briefs covering four questions of law. On April 11, 1955 the Court handed down a supplemental opinion denying the petition for rehearing, and judgment in accordance therewith, was entered April 11, 1955.

Opinions Below

The memorandum opinion of the District Court granting summary judgment is unreported. The original opinion of the Court of Appeals affirming the order of the District Court is reported in 218 Fed. (2d) 64. The opinion of the Court of Appeals denying the petition for rehearing is not yet reported.

Court Rule Involved

Rule 23(c) F. R. C. P. provides in its pertinent portion:

> "(c) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court. If the right sought to be enforced is one defined in paragraph (1) of subdivision (a) of this rule notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs. * * *"

Questions Involved

The question here presented is whether an order of a federal district court pursuant to the above Rule, and a release given pursuant to a compromise thereby approved, is conclusive in favor of persons not parties to the action compromised or to the proceeding leading to the approval of the compromise so as to prevent the release, as to such persons, from being attacked for fraud. This question, which is one of first impression, arises out of the following facts:

The instant case, a stockholders' derivative action, was filed in the federal District Court in New York against allegedly wrongdoing corporate officers and directors. A similar action by other stockholders was thereafter filed in the federal District Court in Michigan. An agreement of settlement was made between the stockholder plaintiffs in the Michigan action, the corporation, and certain individual defendants. After hearing pursuant to Rule 23(c) F. R. C. P., the settlement was approved over the objection of various stockholders including the stockholder plaintiff in New York. The Michigan Court specifically approved the release of all wrong-doing officers and directors, *including those not parties to the proceeding*, over the objection, among others, that the negotiations leading to the settlement were in fraud of the corporation.

Thereafter the defendants in the New York action, including those not parties to Michigan action and proceeding under Rule 23(c), filed a motion for summary judgment in the New York action which was based wholly on the judgment in the Michigan action and the release approved therein. Petitioner, the

stockholder plaintiff in the New York action, resisted on the grounds (a) that the settlement of the Michigan action was procured by fraud, (b) that the decision in Michigan to the contrary was not *res judicata* or otherwise binding in favor of the defendants in the New York action who were not parties to the Michigan action or the settlement proceedings therein, and (c) that accordingly the release given by the corporation pursuant to the order of the Michigan court was, so far as the omitted defendants were concerned, subject to attack for fraud. The District Court granted summary judgment dismissing the complaint. The Court of Appeals affirmed, disagreeing, however, as to the reasons for their action. The decision and opinions of the majority and minority present the following questions:

Question 1

Is the decision of the federal District Court in Michigan approving the settlement binding in favor of defendant directors not parties thereto by way of *res judicata*, collateral estoppel, or otherwise?

Question 2

Aside from any question as to the conclusive effect of the Michigan decision, is the release given by the corporation to the defendant directors not parties to the Michigan action or proceedings conclusive as against a claim of fraud in the settlement?

The majority of the Court, Judges Learned Hand and Frank, held that the Michigan order was not *res*

*judicata** as to the defendants in the New York action who were not present in Michigan. The majority further held, however, that the release was nevertheless conclusive as to such omitted defendants because the corporation so intended. It failed to explain how this intent could be effective if fraudulently procured by the controlling directors who were releasing themselves, or why, in the absence of *res judicata*, petitioner was precluded from litigating in New York the issue of fraud in procuring the release.

Judge Clark agreed as to the result but not as to the reasoning. In his opinion the corporation's consent to the release was ineffective against a claim of fraud unless the prior decision and order of the Michigan Court was conclusive even as to parties not before the Court. Judge Clark thought it was so conclusive.

Statement

The action herein was brought by petitioner, a stockholder of Kaiser-Frazer Corporation, on behalf of the corporate defendant Kaiser-Frazer against Henry Kaiser and nine other officers and directors of Kaiser-Frazer, to recover for the illegal and negligent expenditure of corporate funds which Kaiser and the other directors caused Kaiser-Frazer to make in the purchase of its own stock in a vain attempt to "stabilize" the market for Kaiser-Frazer shares in connection with a new public offering of such shares. It was alleged that in such stabilization, Kaiser and

* The Court obviously used the term "*res judicata*" in its broad sense to include collateral estoppel. *Cf. Lawlor* v. *National Screen Service Corp.*, No. 163, October Term, 1954, decided June 6, 1955. Since nothing here turns on the distinction between *res judicata* and collateral estoppel we follow the Court below in using the former term to include the latter.

the other individual defendants violated the anti-manipulation and anti-fraud provisions of the Securities Exchange Act of 1934 and the Securities Act of 1933; and in addition, were culpably negligent in wasting Kaiser-Frazer's money* (R. 52a, 19).** In *Stella* v. *Kaiser-Frazer Corp. et al.*, 82 F. Supp. 301, the District Court sustained the complaint as alleging a good cause of action under the Securities Exchange Act of 1934; and overruled defendants' pleas to the jurisdiction and venue and motions to quash extra-territorial service, holding applicable the special venue and service provisions of that Act (R. 52a).

Additional stockholder actions on various claims were pending in other jurisdictions, state and federal. Among these was an action in the federal District Court in Detroit, Michigan. This action, brought after the action below, included a claim for relief based on substantially the same facts. However, this claim was based solely on common law grounds and

* The events relating to this "stabilization" received nation-wide publicity and resulted in multiple litigation. Following the failure of the public offering of Kaiser-Frazer stock, Otis & Co., one of the underwriters, refused to comply with its contract to purchase the new shares, whereupon Kaiser-Frazer sued and recovered judgment for over $3,100,000. This judgment was reversed on the ground that Kaiser-Frazer in its registration statement and prospectus had misrepresented its past profits, with the result that Otis & Co. was released from liability (*Kaiser-Frazer Corporation* v. *Otis & Co.*, 195 Fed. (2d) 838, cert. den. 344 U. S. 956).

** Petitioner's appendix below is numbered 1a to 93a. Respondents' appendix is numbered 1 to 121. The record on a former appeal in the case of *Masterson et al.* v. *Pergament et al.* (copies of which were filed in this Court in support of petition for certiorari No. 133 October Term 1952) was incorporated by reference in respondents' reply affidavit R. 112, 113. This record will be hereafter referred to as P. R. [Pergament record].

jurisdiction was based solely on diversity of citizenship (R. 52, 53). For this reason one of the defendants in the New York action, Brown, was dropped as a party in the Michigan action because his citizenship was the same as that of one of the plaintiffs therein; and service could not be had on certain non-resident defendants. The result was that of the ten individual defendants in the New York action only three were in court in Michigan and parties to the Michigan decree. (*Infra* p. 8, footnote *).

Following the decision of the New York Federal District Court, *supra*, sustaining the complaint, jurisdiction venue and service in the instant case, the individual defendants approached counsel for the stockholder plaintiffs in the Michigan action and concluded an agreement for settlement subject to the approval of the Michigan Court. Negotiations were secret, and petitioner and his counsel were excluded therefrom (R. 53a). The settlement was brought on for approval, in Michigan, pursuant to Rule 23(c). Petitioner and certain stockholder plaintiffs in other actions appeared and contested this settlement as inadequate and as procured by fraud. The District Court nevertheless approved this settlement. *Pergament* v. *Frazer*, 98 F. Supp. 9. The Court of Appeals affirmed, Judge Allen dissenting.* This Court denied certiorari, 346 U. S. 832.

* Judge Allen agreed with opposing stockholders that the settlement was procured by fraud. See her summary (R. 57a-62a). As we read the majority opinion, the majority did not disagree with Judge Allen but affirmed on the ground that whatever the fraud in the negotiations, the situation was thoroughly explored before the District Court and since there was no fraud *on him* he had power to approve the settlement as in the interest of Kaiser-Frazer despite any fraud in the negotiations. See p. 18 *infra* footnote **. The Court of Appeals below, however, disagreed

Thereafter the individual defendants in the New York action whose release had been approved by the Michigan Court, moved for summary judgment in New York solely on the basis of the Michigan order and the release thereby authorized. Petitioner resisted on the ground, among others, that seven of the ten individual defendants in the New York action were not parties to the Michigan action and/or the settlement proceedings therein. The facts in this regard are stated in the footnote below.*.

---

with our construction and held that the majority in the Sixth Circuit determined that there was no fraud in the settlement. Since we do not consider this point an appropriate one for certiorari, we will assume, *arguendo*, in this petition that the Court of Appeals in the Sixth Circuit found that there was no fraud in the settlement.

* Defendant Brown was originally a party to the Michigan action but was dropped by amendment because his citizenship, the same as that of one of the plaintiffs, destroyed diversity. Another defendant, Edgar Kaiser, was not named as a defendant in the cause of action in Michigan which arose out of the same facts as the New York action (R. 64a 58, P. R. 22). Three other defendants in the New York action, Sherwood, Trefethen and Motter, were not served and did not appear (R. 8a, 64a). Three other defendants, Bedford, MacDonald and Price, were served and appeared in the action prior to the settlement proceedings (R. 8a).

After the settlement hearing was noticed but before it commenced, the two remaining defendant directors, Henry Kaiser and Joseph Frazer, filed answers to the amended complaint in the action (P. R. 7). In the Sixth Circuit, settlement proceedings are considered in the nature of proceedings ancillary to the principal action and are brought on by notice to show cause which makes the stockholders to whom the notice is directed defendants in the settlement proceedings. *Cohen* v. *Young*, 127 F. (2d) 721, 724. Accordingly, the appearance of Henry Kaiser and Frazer in the main action subsequent to the initiation of settlement proceedings under Rule 23(c) did not make them parties to the settlement proceedings even though they would have been parties to the action had it subsequently been tried.

The petition for settlement was signed only by counsel for Kaiser-Frazer and for the plaintiff stockholders (R. 7a, 8a, 11a). At the settlement hearings appearances were entered only for

The Court of Appeals found, pp. 25, 26 *infra*, that all the defendants below, except Brown, were parties to the Michigan proceeding and decree. This finding, except with respect to Edgar Kaiser, is contrary to the record, as summarized in the preceding footnote, and is erroneous in fact.* However, we realize that factual errors of this nature do not usually move this Court to grant certiorari. Furthermore the Court of Appeals agreed with us that Brown was not a party to the Michigan action and could not have been a party because this would have destroyed diversity (p. 26, *infra*). Accordingly, we will hereafter, for convenience, present this petition in terms of Brown only. However, if the petition is granted we believe that the review should, in the interest of justice, not be limited to the case of Brown but extend to that of all the defendants not parties to the Michigan decree; and that in the event of reversal the case be remanded to the Court of Appeals for further findings, under appropriate instructions, respecting the omitted defendants.

Kaiser-Frazer, Edgar Kaiser, Bedford and Price who had theretofore appeared in the action (P. R. 302). The order approving the compromise did not recite the appearances of any of the individual defendants. Notice of entry of this order was signed only by counsel for the plaintiff stockholders and for Kaiser-Frazer (P. R. 291, 290). See also R. 64a, 65a.

* As to Edgar Kaiser, the Court of Appeals held as a matter of law (p. 25 *infra*) that since he was named as a party to other counts in the Michigan action "his presence in that suit made him fully amenable to all claims that might be present by amendment or otherwise and hence subject to a decree specifically settling all such claims. Hence, by familiar principles of mutuality of estoppel, *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.*, 225 U. S. 111, plaintiff is also bound." We disagree with the Court's conclusion which is not supported by anything in *Bigelow* and is contrary to commonly accepted principles. The question is not whether Edgar Kaiser could have been added by amendment as a defendant in the cause of action in Michigan based on the facts alleged herein; in fact, he was not.

The Opinions Below

The principal opinion below was by Judge Clark with Judges Learned Hand and Frank agreeing with the decision except as to Brown, and concurring as to Brown but for a different reason. On rehearing Judges Learned Hand and Frank wrote the majority opinion in which Judge Clark concurred but for a different reason. These various opinions may best be understood, we believe, in terms of Judge Clark's original opinion.

Petitioner below relied heavily on *Bigelow* v. *Old Dominion Copper Co.*, 225 U. S. 111, which holds that one of two wrong-doing corporate fiduciaries was not exonerated by a judgment in favor of the other in an action to which the first was not a party. In *Lawlor* v. *National Screen Service Corp.*, decided June 6, 1955, this Court reaffirmed the holding of *Bigelow* in this respect. Judge Clark thought that *Bigelow* was not controlling. He frankly expressed disapproval of the doctrine of mutuality of estoppel laid down in *Bigelow* and agreed rather with the views of the Court of Appeals for the Third Circuit in *Lawlor*, 211 F. (2d) 934, 937, which this Court had not yet reversed. He further thought that in stockholder litigation it would frequently be impossible, because of identity of citizenship of plaintiffs and defendants or otherwise, to get all prospective defendants into the court approving the settlement. Hence, he thought, in order to make Rule 23(c) work effectively unattackable releases had to be given subject to court approval, to

all possible defendants, whether in court or not.* While we disagree with the end result reached by Judge Clark, we understand the route by which he reached it. All we can say is that this disregard of *Bigelow* (later reaffirmed in *Lawlor*) and attempt to extend federal diversity jurisdiction to cases between citizens of the same state would seem to merit review by this Court.

The majority refused to subscribe to Judge Clark's reasoning, but reached the same result. Starting from the premise that *Bigelow* correctly states the law—that a judgment in favor of one defendant joint tortfeasor is not available as a defense to another joint tortfeasor not a party to the action—the original majority opinion holds that the release, independently of the judgment, released Brown, because such was the intention of the parties thereto. In reply to petitioner's argument that he wished to litigate the issue whether the release was secured by fraud—which he insisted he could do unless estopped by the Michigan judgment approving the settlement—the majority said:

> "The corporation had actually executed the release, and the Michigan judgment did no more, and needed to do no more, than decide that the consent so given was not vulnerable to any attack by the releasor" (*infra* p. 32).

---

* Judge Clark also suggested that the defendant directors constitute a class; hence, the absent ones might be represented by those in court. This question was briefed on petition for rehearing wherein petitioner argued (a) that the Michigan action, so far as defendants were concerned, did not purport to be a class action; (b) the defendant directors, ten in number, were not sufficiently numerous to constitute a class, and (c) the class at most would be a "spurious" class and the judgment therein would not be binding on those who did not care to join therein (3 Moore Fed. Pract., 3423-4, 3421-2, 3442-3, 3464, 3466, 3470-2). On rehearing Judge Clark did not again advert to this suggestion.

On petition for rehearing the petitioner suggested that this sentence seemed to re-adopt the application of *res judicata* which the majority initially rejected. In response the majority said: (p. 34 *infra*)

> "We repeat what we thought we had said before: The question is not whether the Michigan judgment is *res judicata* here; *Bigelow* v. *Old Dominion Copper Co.*, 225 U. S. 111, has no bearing on the appeal."

This would seem conclusive as to the majority rationale, except for the fact that the majority concludes with the following: (p. 34 *infra*)

> "The only relevant fact is that the corporation's release of the defendants in the Michigan action is beyond any challenge by it, whether it is represented by this plaintiff or any other shareholder. This being so, the sole and only question is whether that release *ipso facto* effected a release of Brown; as it did because such is the federal law."

The "federal law" referred to is the holding in *McKenna* v. *Alston* (C. A. D. C.), 134 F. (2d) 659, 664, that a release of certain joint tortfeasors releases the remainder if such is the intention of the parties. We have no quarrel with this rule but consider it beside the point. The question in *McKenna* was whether a defendant not specifically included in the release was released by operation of law. There was no question of fraud in obtaining the release. In the instant case the release specifically and intentionally released Brown. No question was raised as to intent; the sole point made was that the release was secured by fraud.

Accordingly, the reasoning of the majority (1) that it was intended by the release to release Brown and (2) that such intent is "beyond challenge" finds no support in *McKenna*. Furthermore it wholly fails to explain *what principle of law, other than the usual rules of res judicata, prevents petitioner from challenging this release for fraud.*

We fully agree with Judge Clark's view that intent to release is not enough; that to intent there must be added the coercive effect of the order of the court under Rule 23(c) whether by virtue of *res judicata* or the same doctrine under a different name; otherwise the intent is vulnerable to attack for fraud. As Judge Clark says in his concurring opinion on rehearing: (p. 35 *infra*)

> "I concur in the result reached, but still believe that emphasis on intent without recognition or notice of the crucial role of the federal rule in making that intent operative misstates the problem. It is Hamlet with the Prince's role omitted. Stella and the other stockholders were pursuing a right of action which *they* had (whether one adds 'in right of the corporation' or not). Unless they consented or lost on a judgment on the merits—actually they could not have consented less and there was no trial—the only way they could be eliminated was by operation of F. R. 23(c) in the way stated in my original opinion. The opinion herewith has to get its authority from the rule's operation; so to recognize now would avoid confusion in the event of future resort to the decision as a precedent."

We submit that the rationale of the majority completely fails to explain why petitioner is precluded

from attacking the release for fraud if not precluded by virtue of the alleged conclusive effect of the order under Rule 23(c). If this Court agrees with this view, which is substantially Judge Clark's view, it should review this case, even if inclined to affirm the result, in order that the decision, if affirmed, should be on proper grounds. *Hurn* v. *Oursler*, 289 U. S. 238, 240.

This is not mere academic precision. In a comparable case dealing with the effect of a foreign judgment in stockholder litigation, the New York Supreme Court has held that it would give to the judgment of the foreign court only such effect as it was compelled to give by the usual rules of *res judicata*. *Darraugh* v. *Carrington*, 50 N. Y. S. 2d 481, 487, Shientag, *J.** Other state courts and federal courts in other circuits may take the same view. If Judge Clark's nationwide system of settlement by a decree binding upon absent parties, as well as those in court, is to be respected by other courts, including those which have

---

* This was a motion for summary judgment to dismiss a stockholder's derivative action based on a California judgment, on the merits, in a similar action. The California judgment recited that the issues raised therein were raised in actions pending in other jurisdictions, including New York, and purported to adjudicate all such issues. Judge Shientag held that the issues before him were not adjudicated because the issues were different and some of the parties were different. Adopting the language of Judge MacLaughlin in the companion case of *Gans* v. *Hursl*, 50 N. Y. S. 2d 475, he said the California court "had no power by its own decree to clothe its judgment with a greater effect than that to which it is entitled under the principles of *res judicata* above discussed". He expressly held that identity of parties as well as issues must exist in order for *res judicata* to apply, citing as authority the recent decision of the Court of Appeals in *Elder* v. *New York & Pennsylvania Motor Express, Inc.*, 284 N. Y. 359.

first obtained jurisdiction, it can only be by virtue of the declaration by this Court that such decisions are *res judicata* as to all.

Of course, if the result reached below is wrong, review should, *a fortiori*, be granted.

Reasons for Granting the Writ

1. *The Court below has decided an important question of federal law which has not been, but should be, decided by this Court.*

The precise point presented is one of first impression. As the Court below decided, it is one of federal law. The confusion in the reasoning below, to which Judge Clark refers, increases the desirability that this Court settle the point at issue.

Whatever the rationale, the decision below comes down to this: Brown, over whom the federal court in Michigan had, and could have, no jurisdiction (because his inclusion in the action or proceeding would have destroyed diversity), is nevertheless conclusively released by action of that court so that the release cannot be questioned for fraud in any other court including one which had previously secured jurisdiction over Brown.

The juridical importance of this extension of diversity jurisdiction is obvious. Its practical importance in the settlement, under Rule 23(c), of nation-wide corporate litigation is equally obvious. Whether these consequences be thought good or bad the proper rule, and the reasons therefor, should be stated by this Court.

2. *The Court below in holding that the order of the Michigan Court and/or the release given pursuant thereto is beyond attack, for fraud, in another court, even as to persons not parties to the Michigan order or proceedings, has decided an important question of federal law in a way probably in conflict with applicable decisions of this Court and of courts of appeal in other circuits.*

The rule of mutality of estoppel in suits against joint tortfeasors laid down by this Court in *Bigelow** and followed in various circuits** would seem to require the holding that the decision in Michigan does not estop petitioner, as to Brown, from relitigating the issue of fraud in procuring the release. Judge Clark recognized the force of *Bigelow* but expressed the belief that its "much criticized" policy should not be applied in the context of settlement proceedings under Rule 23(c) (*infra* p. 26). However, in *Lawlor*

---

* The holdings in *Bigelow* here pertinent were (1) that it is a principle of elementary law that the estoppels of a judgment must be mutual; (2) that to this rule there is an exception "where the culpability of defendant is altogether dependent upon the culpability of one exonerated in a prior suit upon the same facts when sued by the same plaintiff" (225 U. S. 1, pp. 127, 128) and (3) that this exception does not apply in the case of wrongdoing corporate fiduciaries who are joint tortfeasors, jointly liable, neither being secondarily liable merely on account of the wrong of the other.

** *Cf. Lewis* v. *Ingram* (8th Circ.), 57 Fed. (2d) 463, 465, where the Court said "that another trial court hearing what we assume to be substantially the same evidence, came to the conclusion that fraud had not been proven [in a prior suit against two of three wrongdoing fiduciaries] is a circumstance worthy of serious consideration; but it does not relieve the trial judge from the duty of exercising his own judgment as to the facts nor foreclose him from finding that there was bad faith." The court held that the prior decision of another federal court, affirmed in the Fifth Circuit, exculpating two of three allegedly wrongdoing fiduciaries, was not *res judicata* as to the third when sued in the Eighth Circuit.

v. *National Screen Service Corp.* (June 6, 1955) this Court adhered to this "much criticized" policy and specifically held that joint tortfeasor defendants who were not, and could not have been, parties to a decree, could not rely on it as *res judicata*. Had Judge Clark's opinion been the majority opinion we believe that this Court's subsequent decision in *Lawlor* would have made the grant of certiorari practically automatic. *Cf. Myers* v. *Reading Co.*, 331 U. S. 477, 479. We submit that the result should be no different merely because the majority disclaimed any intention to circumvent or limit *Bigelow* but has placed its decision upon other grounds which, as Judge Clark pointed out, are obviously beside the point.

As shown by the analysis of the majority opinion, *supra* pp. 11-13, the majority simply says (1) the decision is not *res judicata;* (2) however, the release covers Brown because so intended, and (3) the release is "beyond challenge" for fraud. This final statement, we submit with deference, is either a mere *ipse dixit,* or a readoption under another name, or no name, of the doctrine of *res judicata* theretofore rejected. As Judge Clark says, the omission to consider the coercive effect of the order of the Michigan Court is "Hamlet with the Prince's role omitted." We submit that the majority rationale disposes neither of the conflict with *Bigelow,* and hence with *Lawlor,* nor of the necessity of giving consideration to the alleged coercive effect of an order under Rule 23(c) upon which Judge Clark relies.

3. *The decision below violates an important federal policy in facilitating questionable settlements of admitted wrongs by corporate fiduciaries, and is in probable conflict with decisions of this Court establishing such policy.*

The decision of the Court of Appeals for the Sixth Circuit holds that the claim sued on below, and certain claims presented in other stockholder actions, were meritorious.* The decision of such Court of Appeals further shows that the claim of fraud in the settlement is one of substance and that there is a substantial probability that petitioner might have sustained this claim had he been allowed to present it below.**

Heretofore this Court has insisted upon strict accountability of corporate fiduciaries, and has placed

---

* The District Judge found merit in three of the nine claims settled upon evidence which indicated their value of $2,300,000 to $4,100,000 in round figures, exclusive of interest. The Court of Appeals found merit in another cause of action, the one sued on below, which fairly added a further principal liability of $1,700,000, bringing the total to $4,000,000 to $5,800,000. Judge Allen valued these claims up to a total of $10,500,000. *Masterson* v. *Pergament*, 203 F. (2d) 315, 325-329, 331, 335.

** Judge Allen summarized the evidence which in her opinion showed fraud in the settlement negotiations. The principal actor in these proceedings was Brown. Judge Allen wrote "At the proceeding in the District Court, he [Brown] testified that in these negotiations with Chess and Perlman [attorneys for the settling stockholders] his effort was to get the easiest possible terms of settlement for the individual defendants [including himself] * * * and that he therefore avoided making disclosures or stating facts or furnishing information that would support a recovery for Kaiser-Frazer in these suits. This striking admission was made although Brown's firm was paid by Kaiser-Frazer for these negotiations" (R. 58a, 59a).

The majority of the Court of Appeals for the Sixth Circuit—so the Court of Appeals below held—disagreed with Judge Allen's conclusion that the settlement was fraudulent, albeit in somewhat

upon them the burden of proof, when challenged, to show that their dealings with the corporation were both fair in result and fairly conducted. *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 599; *Pepper* v. *Litton*, 308 U. S. 295. As this Court said in the latter case, at p. 306:

> "A director is a fiduciary. *Twin-Lick Oil Co.* v. *Marbury*, 91 U. S. 587, 588. So is a dominant or controlling stockholder or group of stockholders [Henry Kaiser and Joseph Frazer]. Their powers are powers in trust. See *Jackson* v. *Ludeling*, 21 Wall. 616, 624. Their dealings with the corporation are subjected to rigorous scrutiny, and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but to show its inherent fairness from the viewpoint of the corporation and those interested therein."

We do not believe that a proceeding to approve a settlement under Rule 23(*e*) should be used as a device to excuse corporate fiduciaries from this strict accounting. True, a director when once exonerated should not be again compelled to explain and to justify; but heretofore under *Bigelow*, this has meant that unless such director was a party to the first action

---

ambiguous terms." What the majority said was that it refused "to be led into a discussion" of the question of fraud in the settlement because the District Court in hearing evidence as to the advisability of settlement "sat as a third party to the compromise" and there was no fraud *as to him*. The majority then added "in any event he ruled against the objectors upon these matters upon consideration of substantial evidence and in the exercise of a sound judicial discretion." 203 F. 2d, 331, R. 82a. (Emphasis ours.)

he could not claim the benefit of a favorable decision therein. Despite criticism by some courts and text writers* this Court has recently refused in *Lawlor* to change the rule of *Bigelow*.

Accordingly, the infringement below of the requirement of mutuality of estoppel set forth in *Bigelow* and *Lawlor* equally infringes the policy of strict scrutiny of dealings between directors and their corporation, set forth in *Geddes* and *Pepper*. Indeed, if the statement of the majority below that they rely wholly on the release and not at all on the Michigan judgment is to be taken at face value, their decision, in attempting to avoid *Bigelow*, collides squarely with *Geddes* and *Pepper*.

PRAYER

For the foregoing reasons petitioner prays that this petition be granted to the end that this case may be reviewed and determined by this Court; that the judgment of the Court of Appeals be reversed; and that the petitioner be granted such other and further relief as may be proper.

Respectfully submitted,

MICHAEL STELLA

By LEWIS M. DABNEY, JR.
Counsel for the above Petitioner
165 Broadway
New York 6, N. Y.

---

* *Cf.* the dissenting opinion of Judge Clark in *Riordan v. Ferguson*, 147 F. (2d) 983, 991-993, to which Judge Clark referred in his original opinion, *infra* p. 26.

Original Opinion of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 60—October Term, 1954

Argued October 7, 1954 Decided December 7, 1954

Docket No. 23107

MICHAEL STELLA, on behalf of himself and all other stockholders of Kaiser-Frazer Corporation,

Plaintiff-Appellant,

v.

HENRY J. KAISER, JOSEPH W. FRAZER, EDGAR F. KAISER, G. G. SHERWOOD, E. E. TREFETHEN, JR., CLAY P. BEDFORD, W. A. MACDONALD, O. B. MOFFETT, HICKMAN PRICE, JR., WALSTON S. BROWN and KAISER-FRAZER CORPORATION,

Defendants-Appellees.

Before CLARK, *Chief Judge*, and L. HAND and FRANK, *Circuit Judges*.

Appeal from the United States District Court for the Southern District of New York, Sylvester J. Ryan, *Judge*.

Plaintiff, Michael Stella, appeals from a summary judgment for defendants, finding his stockholders' derivative action against the officers and directors of

Kaiser-Frazer Corporation for alleged mismanagement of the affairs of that corporation barred by a decree of settlement in another action. Affirmed.

See also D. C. S. D. N. Y., 82 F. Supp. 301.

LEWIS M. DABNEY, JR., New York City, for plaintiff-appellant.

H. BARTOW FARR, New York City (Willkie, Owen, Farr, Gallagher & Walton, New York City, on the brief for defendant-appellee Kaiser-Frazer Corporation, and Corbin, Bennett & Delehanty, New York City, on the brief for defendants-appellees Henry J. Kaiser, Joseph W. Frazer, Edgar F. Kaiser, G. G. Sherwood, E. E. Trefethen, Jr., Clay P. Bedford, W. A. MacDonald, O. B. Motter, Hickman Price, Jr., and Walston S. Brown), for defendants-appellees.

CLARK, *Chief Judge.*

This appeal concerns the effect as res judicata and bar of a decree of settlement of a stockholders' derivative action entered by a federal court pursuant to F. R. C. P. 23(c), and of the releases executed thereunder. Plaintiff-appellant is one of several stockholders bringing a variety of derivative actions on behalf of the Kaiser-Frazer Corporation against its officers and directors. By order of a United States District Court in Michigan, after due notice, all claims were there consolidated and a settlement was reached which purported to bind all stockholders and all officers of the corporation. *Pergament* v. *Frazer*, D. C. E. D. Mich., 93 F. Supp. 13-45. Despite vigor-

ous protest by several stockholders, including plaintiff, the Court of Appeals affirmed the settlement, *Masterson v. Pergament*, 6 Cir., 203 F. 2d 315-336, and the Supreme Court denied certiorari, 346 U. S. 822. When plaintiff thereafter sought to resume in the district court below the action he had begun before the institution of the Michigan proceedings, see *Stella v. Kaiser*, D. C. S. D. N. Y., 82 F. Supp. 301, defendants-appellees successfully pleaded the Michigan judgment in bar. In asking us to reverse the entry of summary judgment below, plaintiff attacks the conclusive nature of the Michigan settlement on a variety of grounds.

Plaintiff's complaint charged breach of fiduciary duty in defendants' attempted stabilization of the price of Kaiser-Frazer stock at the time of a public stock offering in February, 1948. There is apparently no claim of illicit personal gains made by defendants at the corporation's expense. The gravamen of the complaint is violation of the antimanipulation and antifraud sections of the Securities Exchange Act of 1934 and the Securities Act of 1933, together with negligent waste of Kaiser-Frazer's corporate assets. *Cf. Kaiser-Frazer Corp. v. Otis & Co.*, 2 Cir., 195 F. 2d 838, certiorari denied, 344 U. S. 856.

There is no doubt that this claim was one of those compromised and settled by the Michigan decree. See *Pergament v. Frazer, supra*, D. C. E. D. Mich., 93 F. Supp. 13, 33-35. Plaintiff was an active litigant in the proceedings there and is bound under the principles of res judicata at least with respect to those defendants who were parties of record in Michigan. *Baldwin v. Iowa State Traveling Men's Ass'n*, 283

U. S. 522. Even without his active participation Stella would have been bound by the Michigan court's action, since it was a conclusive adjudication of a "true" class action, *Hansberry* v. *Lee*, 311 U. S. 32, 132 A. L. R. 741; 3 Moore's Federal Practice ¶ 23.11 (2d Ed. 1948); McLaughlin, *Capacity of Plaintiff-Stockholder to Terminate a Stockholder's Suit*, 46 Yale L. J. 421, 424, and since, moreover, there was adequacy of notice and representation as found by the Sixth Circuit, *Masterson* v. *Pergament, supra*, 6 Cir., 203 F. 2d 315, 330. See *Dickinson* v. *Burnham*, 2 Cir., 197 F. 2d 973, certiorari denied 344 U. S. 875, and proposed Rule 23(d) in Preliminary Draft of Proposed Amendments to Rules of Civil Procedure for the United States District Courts, May 1954, pp. 15-17, discussed in Wright, *Amendments to the Federal Rules: The Function of a Continuing Rules Committee*, 7 Vand. L. Rev. 521, 539-540.

Plaintiff asserts, however, that the settlement itself was procured by fraud and that the Michigan decree is subject to attack for failure to decide this issue. But in this he is in error, for the fraud issue was in fact disposed of adversely to him by the Court of Appeals: *Masterson* v. *Pergament, supra*, 6 Cir., 203 F. 2d 315, 330-331. Since this issue was repeatedly raised, it cannot now be made the basis for collateral attack. *De Bobula* v. *Goss*, D. C. Cir., 193 F. 2d 35.

Plaintiff's further argument vigorously pressed that the Michigan proceedings are not res judicata because they were merely administrative borders on the fantastic. It can hardly be claimed that that ancient device of a court of equity, the class suit, is nonjudicial; and there is nothing in the substantive provisions

of this rule—"A class action shall not be dismissed or compromised without the approval of the court"—to change its character. Actually, as is well settled, the federal district courts, as constitutional courts, have only judicial, and no administrative, jurisdiction, *Keller* v. *Potomac Electric Power Co.*, 261 U. S. 428, and the Federal Rules do not and cannot change that jurisdiction. F. R. C. P. 83, 28 U. S. C. § 2072. In none of the cases or authorities dealing with this rule and cited *supra* is there any suggestion that its impact is other than completely judicial. Plaintiff places considerable reliance upon district court rulings departing from the usual conceptions of a trial such as refusal of examination before trial and admission of incompetent evidence. Those have not been reviewed on appeal; whether correct or not, they cannot negative district court jurisdiction any more than can certain expressions attributed to defendants, but quoted rather out of context.

Plaintiff's most cogent attack on the Michigan decree focuses on the lack of complete identity between the parties of record here and in Michigan. One of the defendants, Edgar F. Kaiser, although he was a party to the Michigan suit, was not named in that count of the Michigan complaint which dealt with plaintiff's particular claim. Nonetheless, his presence in that suit made him fully amenable to all claims which might be present by amendment or otherwise and hence subject to a decree specifically settling all such claims. Hence by familiar principles of mutuality of estoppel, *Bigelow* v. *Old Dominion Copper Mining & Smelting Co.*, 225 U. S. 111, plaintiff also is bound. All of the other defendants except Walston

S. Brown were named as defendants both of the decree in general and of this particular count. Thus they satisfy all requirements of identity, and res judicata applies. This leaves only the case of Brown, to which we now turn.

At first glance plaintiff's contention that he should be allowed to pursue his claim against Brown seems to have considerable force. Brown was originally a party to the Michigan action, but was dropped because his presence would have destroyed the diversity jurisdiction of the Michigan court. His participation was thus limited to the giving of testimony. But even so, we think a more complete analysis requires the rejection of the contention.

Plaintiff relies heavily on *Bigelow* v. *Old Dominion Mining & Smelting Co., supra,* 225 U. S. 111. But this case decided only the effect which exoneration of one joint tort-feasor should have on a suit against another. The policy reasons against allowance of such exoneration as a bar to action against another, which have been much criticized, see, *e. g., Riordan* v. *Ferguson,* 2 Cir., 147 F. 2d 983, 991-993; *Bruszewski* v. *United States,* 3 Cir., 181 F. 2d 419; Note, *Res Judicata: The Requirement of Identity of Parties,* 91 U. of Pa. L. Rev. 467, have little relevance to the situation of settlement which is before us here. Even if we were to concede, arguendo, that an aggrieved party should have several opportunities to attain one recovery, that would not militate in favor of permitting a double remedy for a single wrong. Either the receipt of full satisfaction for a claim or the unconditional release of it bars the plaintiff from further prosecution of that particular cause of action against any one. *Rushford* v. *United States,* D. C.

N. D. N. Y., 92 F. Supp. 874, affirmed per curiam, 2 Cir., 204 F. 2d 831; *Larabell* v. *Sckuknecht*, 308 Mich. 419, 14 N. W. 2d 50; Prosser, Torts § 109 (1941).

The Michigan compromise was in fact both a satisfaction and a release of plaintiff's claim. The terms of the settlement were carried out and the release was wholly unconditional. No attempt was made in Michigan to reserve rights against the absent Brown; on the contrary, the compromise explicitly purports to release Brown. It may not be clear whether the Michigan findings on the adequacy and the sufficiency of the consideration offered by defendants are to be taken as a determination of the consideration for the release or of the fact of satisfaction of the claim itself. In either case, however, the only issue, as I see it, is whether a judicially effected compromise should have the same binding effect as a voluntary one would have. The writer of this opinion can see no reason why it should not. The judicial scrutiny contemplated by F. R. C. P. 23 (c) gives to the parties a greater degree of protection than do many private settlements. The salutary effect of the rule would be seriously impaired if dissatisfied parties could revive compromised claims against parties whom the settlement expressly covered. The Third Circuit recently held that, even without judicial safeguards, a prior consent judgment may be successfully invoked by any defendants whose relationship to earlier defendants was "close enough." *Lawlor* v. *National Screen Service Corp.*, 3 Cir., 211 F. 2d 934, certiorari granted 75 S. Ct. 42. Here we need not go so far, but may hold simply that a member of the class of stockholders in a derivative action is bound by and must accept a judicially approved compromise in his

behalf. This is the traditional class suit or representative situation, see Advisory Committee's Note to F. R. C. P. 23(a)(1); 3 Moore's Federal Practice 3436, 3437, 3459, 3460 (2d Ed. 1948). Since Stella would thus be bound even by a totally adverse judgment, there seems no reason why he—so represented—should not be bound by the release and satisfaction ordered by the court.

As the concurring opinion herewith shows, my brethren reach the same conclusion as to the operation of the release, but takes a somewhat different path. Accepting the modern law that the release of one joint tort-feasor no longer automatically releases all, they nevertheless assume to find here—apparently from the words of the release itself—the necessary intent of the parties now an essential requisite. On this basis the release operates independently of the legal action which gave it birth and being. Although the result is the essential matter and these nuances of approach may not have great significance to the parties, yet it is desirable from the standpoint of precedent to hew to the correct doctrine, one of potential utility in later cases. And there I feel compelled to suggest, with deference, that I believe my brothers are accepting fiction for fact, with the result of stressing only the nonessential. For, apart from the legal proceedings authorized by the rule, the release cannot have actual validity, nor the releasors the necessary intent. Obviously a number of those necessarily involved did not have the attributed intent; indeed, quite the contrary. That includes all those listed as objectors in the Michigan action, Stella among the rest. Had their objections not been legally surmountable, the release would be without force. Hence we

should examine the legal action which furnishes the legally operative acts, and need spend little effort on some constructive intent assumable once the legal action is found correct. Since that correctness appears here, the rest follows, even my brothers' superstructure of rationale if that is deemed a necessary prop.

In considering the validity of these transactions ordered on behalf of Stella, we look primarily at the protection accorded him in view of his claim that the release is not binding on him, being against his will. But the same result against him seems required under another theory, resting upon strict application of the doctrine of mutuality of estoppel, by regarding Brown as properly represented in the Michigan action. Under this view the Michigan settlement is binding upon Brown and therefore is also res judicata as to Stella. While my brethren do not accept this rationale, is seems to the writer not merely a sound and necessary deduction from the authority given by the rule, but also a desirable use of a too-little employed procedural device. We have noted above the present trend toward a greater binding character for class suits. See particularly the discussion and the authorities cited in *Dickinson* v. *Burnham*, *supra*, 2 Cir., 197 F. 2d 973, 979. Without going so far as many urge, it seems quite appropriate here to hold Brown bound by the Michigan judgment.

Proceedings under F. R. C. P. 23(c) of necessity involve a great number of potential litigants. In order to preserve diversity jurisdiction, some of these interested persons must be excluded from official participation in the action. If these persons are given notice and if they are otherwise adequately repre-

sented, they may nevertheless be bound by the court's decree. In the Michigan litigation in this case the directors, as well as the stockholders, met the necessary qualifications for a class. Their number was so great that jurisdictional considerations made it impossible to join them all as parties; they had substantially identical interests in the litigation, which raised an issue common to them all. *Hansberry* v. *Lee, supra,* 311 U. S. 32, 41; Restatement, Judgments § 86, comment *b* (1942). It was presumably only a matter of convenience that when the diversity problem arose a director, rather than a stockholder, was dropped from the ranks of official litigants. As a member of the class of directors, Brown does not complain, nor could he, of the diligence with which his interests were protected. Hence under the authorities just cited he is bound by the compromise decree, even though he was not an official party to it. The decree thus meets all the requirements of res judicata as to Brown, as well as to all other defendants. And Brown being bound to Stella as one of the parties, Stella is in turn bound as to him.

Affirmed.

L. HAND, *Circuit Judge* (concurring):

I agree in the result as to all the defendants, and in the reasoning by which it is reached as to all except Brown. As to him I rest my vote upon somewhat different grounds. I do not believe that a judgment in favor of one director of a corporation is res judicata in favor of the others; but, since in the case at bar the directors were all joint tortfeasors, I rely upon

the doctrine that the release of one releases all. That doctrine has been somewhat impaired, and was never well grounded in its absolute and unconditional form; but I am content arguendo to accept the following statement of it by Mr. Justice Rutledge (then in the Court of Appeals of the District):* "Whether the settlement is made and accepted as full satisfaction or merely as the best obtainable compromise for the settler's liability is the crucial issue, and ordinarily one of fact. If however the agreement's terms leave no room for doubt, the decision should be made as a matter of law." I also accept the following gloss of the Restatement:** "a document in the usual form of a release given to one of them" (several joint tortfeasors) "is construed as intended to discharge all claims for the tort and operates to discharge others also liable for the same harm." The release in the case at bar satisfied both these tests. Its preambles recited among other things that "the parties desire to dismiss and compromise the stockholders derivative action" (the Michigan suit) "and to resolve all of the controversies raised by the allegations of the amended complaint." Again, "the plaintiffs deem it in the best interest of Kaiser-Fraser * * * that the stockholders derivative action be dismissed and compromised upon the terms and conditions hereinafter set forth." The operative words of release included "all claims, charges and allegations set forth in the amended complaint and the notice to amend and supplement the amended complaint." Finally, the par-

---

* *McKenna v. Austin*, 134 Fed. (2) 659, 664.

** Restatement of Torts, Vol. 4, §885, Comment (d).

ties clearly meant to put an end to any claim against Brown for the release included him, eo nomine; indeed it appears that he was omitted as a defendant to the action only because his presence would destroy the jurisdiction of the court.

Although the Michigan judgment does not estop the plaintiff in this action from attacking the validity of the release as to Brown, and although the district court would therefore be free to decide that it should be set aside, it would still be obliged to dismiss the complaint because the release of the other directors would remain unscathed. The situation might be different if the Michigan judgment had been on the merits of the claim; I need not say whether such a judgment would release Brown. The corporation had actually executed the release, and the Michigan judgment did no more, and needed to do no more, than decide that the consent so given was not vulnerable to any attack by the releasor. That enabled Brown to invoke the doctrine I mention.

Judge FRANK concurs in Judge HAND's opinion.

Opinion on Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 60—October Term, 1954

Submitted February 21, 1955 Decided April 11, 1955

Docket No. 23107

MICHAEL STELLA, on behalf of himself and all other stockholders of Kaiser-Frazer Corporation,

Plaintiff-Appellant,

v.

HENRY J. KAISER, JOSEPH W. FRAZER, EDGAR F. KAISER, G. G. SHERWOOD, E. E. TREFETHEN, JR., CLAY P. BEDFORD, W. A. MACDONALD, O. B. MOTTER, HICKMAN PRICE, JR., WALSTON S. BROWN and KAISER-FRAZER CORPORATION,

Defendants-Appellees.

Before CLARK, *Chief Judge*, and L. HAND and FRANK, *Circuit Judges*.

On Petition for Rehearing.

LEWIS M. DABNEY, JR., for Plaintiff-Appellant.

L. HAND and FRANK, *Circuit Judges*. The appellant begins his petition by saying that it is "addressed to the concurring opinion", and for that reason we

confine ourselves to the point raised therein. First, we hold that the question whether the release of those who were defendants in the Michigan action is a release of Brown is a question of federal law, because the only claim in suit arises under the Securities and Exchange Act. *Garrett* v. *Moore-McCormack*, 317 U. S. 239, *Dice* v. *Akron, etc. Railroad*, 342 U. S. 359. Tested by federal law the appeal falls directly within the doctrine of *McKenna* v. *Austin*, 134 Fed. (2) 659, 664 (C. A. D. C.) for the releasor—i. e. the corporation—expressly included Brown in the release, which can leave no doubt as to its intent. We repeat what we thought we had said before: the question is not whether the Michigan judgment is res judicata here; *Bigelow* v. *Old Dominion Copper Company*, 225 U. S. 111, has no bearing on the appeal. Nor would it better the plaintiff's case, had it appeared that the corporation did not add anything to the consideration for the inclusion of Brown. The only relevant fact is that the corporation's release of the defendants in the Michigan action is beyond any challenge by it, whether it is represented by this plaintiff or any other shareholder. That being so, the sole and only question is whether that release ipso facto effected a release of Brown; as it did, because such is the federal law.

The petition is denied.

CLARK, *Chief Judge* (concurring).

I concur in the result reached, but still believe the emphasis on intent without recognition or notice of the crucial role of the federal rule in making that intent operative misstates the problem. It is Hamlet with the Prince's role omitted. Stella and the other stockholders were pursuing a right of action which *they* had (whether one adds "in right of the corporation" or not). Unless they consented or lost on a judgment on the merits—actually they could not have consented less and there was no trial—the only way they could be eliminated was by operation of F. R. 23(c) in the way stated in my original opinion. The opinion herewith has to get its authority from the rule's operation; so to recognize now would avoid confusion in the event of future resort to the decision as a precedent.